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Remarks

Executive Secretary

13 May 86

Date

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**THE WHITE HOUSE
WASHINGTON**

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CABINET AFFAIRS STAFFING MEMORANDUM

Executive Registry

86- 1996X

Date: 5/12/86 **Number:** 317, 109 **Due By:** -----

Subject: Economic Policy Council Meeting -- May 14, 1986

2:00 P.M. Roosevelt Room

| ALL CABINET MEMBERS | Action | FYI | | Action | FYI |
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REMARKS:

The Economic Policy Council will meet on Wednesday, May 14, 1986 at 2:00 P.M. in the Roosevelt Room.

The agenda and background papers are attached.

RETURN TO:

☒ Alfred H. Kingon
Cabinet Secretary
456-2823
(Ground Floor, West Wing)

☐ Don Clarey
☐ Rick Davis
☐ Ed Stucky

Associate Director
Office of Cabinet Affairs
456-2800 (Room 235, OEOB)

THE WHITE HOUSE

WASHINGTON

May 12, 1986

MEMORANDUM FOR THE ECONOMIC POLICY COUNCIL

FROM: EUGENE J. McALLISTER *EM*

SUBJECT: Agenda and Papers for the May 14 Meeting

The agenda and papers for the May 14 meeting of the Economic Policy Council are attached. The meeting is scheduled for 2:00 p.m. in the Roosevelt Room.

The first agenda item is the Section 201 petition filed by the shake and shingle industry. The President must make a determination on whether to provide relief to the industry by May 24. The TPRG has reviewed the issue and prepared the attached paper describing the merits of the case and outlining several options.

The second agenda item is Brazilian informatics. The President self-initiated a Section 301 investigation of Brazil's informatics policy last September. Efforts to negotiate with Brazil have been relatively unsuccessful thus far. The TPRG is presenting for the Council's consideration several options for creating greater momentum in our negotiations. A paper prepared by the TPRG is attached.

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THE WHITE HOUSE

WASHINGTON

ECONOMIC POLICY COUNCIL

May 14, 1986

2:00 p.m.

Roosevelt Room

AGENDA

1. Section 201 Petition -- Shakes and Shingles
2. Brazilian Informatics

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OFFICE OF THE UNITED STATES
TRADE REPRESENTATIVE
EXECUTIVE OFFICE OF THE PRESIDENT
WASHINGTON
20506

May 12, 1986

MEMORANDUM FOR THE ECONOMIC POLICY COUNCIL

FROM THE TRADE POLICY REVIEW GROUP

SUBJECT: Section 201 Shakes and Shingles Petition

Issue: Should the President grant import relief to the U.S. western red cedar shakes and shingles industry and, if so, what type of relief should he grant?

Background

. On February 26, 1986, U.S. International Trade Commission (ITC) determined by 4-2 vote that increased imports are seriously injuring U.S. wood shake and shingle industry.

. On March 25, by 3-3 vote, recommended imposition of a 35 percent tariff for five years on imports of western red cedar (wrc) shakes and shingles.

. Trade Act of 1974 requires that the President decide within 60 days of receiving ITC's report, or by May 24:

(1) whether to grant import relief; and

(2) if relief is granted, what form and level are required.

. Law requires him to determine whether relief would be in national economic interest.

. Should the President choose no relief, or an approach different from that recommended by ITC, he would be required to set forth reasons for his decision and to explain steps he is taking, beyond expedited adjustment assistance, to help industry overcome serious injury. Congress may override his decision and implement ITC decision by passing a joint resolution; the President could, however, veto this resolution.

Basic Facts

. Health of U.S. wrc shakes and shingles industry generally declined over 1978-1984 period, partly as a result of declining housing starts during that period.

(1) U.S. consumption fell from 7.5 to 5.7 million squares

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S. Bruce Wilson

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("square" refers to quantity required to cover 100 square feet of surface area).

(2) Domestic production dropped almost steadily from 4.3 to 2.1 million squares.

(3) Number of all shake and shingle establishments estimated to have fallen from 445 firms to 255 firms by June of 1985.

(4) Employment declined from 4,531 to 2,146.

(5) Capacity utilization fell from 54 percent in 1980 to 44 percent during first nine months of 1985.

(6) Only in area of net income did U.S. firms show improvement, i.e., from 5.3 percent net loss from net sales in 1982 to 3.4 percent net income in first nine months of 1985.

. Imports of wrc shakes and shingles -- virtually all of which come from Canada -- increased over period.

(1) On volume basis, imports rose from 3.3 million squares in 1980 to nearly 3.7 million squares in 1984.

(2) On value basis, imports grew from \$139.7 million to \$162.5 million.

(3) Ratio of imports of all shakes and shingles (majority of which are wrc) to consumption grew from 40 percent in 1978 to 73 percent during first nine months of 1985.

. Industry faces number of difficulties in addition to those posed by import competition.

(1) Saddled with declining resource base. Estimated that, at current harvesting levels, U.S. old growth red cedar will be available only until 2006. Were U.S. harvesting to rise, resource base would fall even more rapidly. By contrast, Canada expects to have supplies into twenty-second century.

(2) Canadian restrictions on log exports have exacerbated inelastic supply situation here and increased U.S. raw material costs relative to those in Canada.

(3) Substitute siding and roofing materials, e.g., asphalt, tile and fiberglass, already account for 90 percent of consumption and could take more of market were tariffs to lead to appreciably higher prices.

(4) Anti-flammability treatment requirements have nearly doubled cost of a square of wrc shakes and shingles (i.e., from \$40 to \$70), further reducing their competitiveness.

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Major Policy Objectives

. Law requires the President to make his decision by considering certain statutory criteria, which are broader than those ITC considers in determining whether to provide import relief. Most important economic criteria include:

1. Adjustment. In this case, can import relief allow U.S. firms to adjust to greater international competitiveness? Would relief encourage remaining U.S. firms -- now small, family-run operations -- to pool resources for vitally-needed research into alternative raw materials and improved anti-flammability treatments? (Industry says yes.) Would adjustment costs for workers and producers be reduced? To what extent would a price increase for wrc shakes and shingles encourage consumers to switch to alternative roofing and siding materials, thereby hastening industry's demise?
2. Domestic economic costs. To what extent would import relief impose costs on: (a) U.S. consumers (CEA estimates that ITC-recommended tariff relief could cost consumers between \$14 and \$25 million, or \$262-\$334 thousand per job created); (b) other U.S. industries, because Canada might retaliate (despite the fact that U.S. is free to raise its zero tariff on shakes and shingles under GATT rules); and (c) U.S. economy, because import restrictions will make it less efficient?
3. International economic costs. To what extent would import relief hurt Canada?

Agencies considered range of import relief options, including tariffs, quotas, tariff-quotas and orderly marketing agreements.

The majority view was that there is little economic justification for granting relief.

However, some agencies found that relief would be warranted if, (1) industry channels increased profits generated from tariff relief (and hence higher prices) into research for alternative wood species raw materials and improved anti-flammability; and (2) this research results in more competitive product with nearly limitless raw material bases; or (3) USG is able to negotiate log supply access agreement with Canada.

Finally, there was consensus that EPC might want to consider certain political criteria:

1. Risk of an alternative, less desirable, legislative solution. Given that this is first 201 case since nonrubber footwear, what is risk that rejection of relief for wrc shakes and shingles will encourage passage of pending legislation reducing presidential discretion under 201?

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2. Other action involving wood products. Would granting relief complicate efforts to find bilateral solution to lumber trade problem (i.e., low stumpage pricing) with Canada? Would such action improve or harm efforts to negotiate a bilateral liberalization of log export controls? Would denial of import relief encourage Congressional efforts to include natural resource pricing as countervailable subsidy?

Policy Options

. TPRG reviewed a number of options and selected three for EPC consideration. Relief options were narrowed to tariffs, with only variations being possible duration and extent of degressivity.

Option 1: Provide no import relief.

Advantages

- o No cost to consumers.
- o No threat of retaliation from Canada.
- o Consistent with U.S. pledge regarding standstill and rollback of protectionist measures.
- o Consistent with spirit of 201, which envisions import relief as means of promoting adjustment rather than encouraging maintenance of noncompetitive industries.
- o Could lead to fewer Congressional demands (than under options 2 and 3) for import protection for textiles and footwear, on grounds that these are larger industries than shakes and shingles.

Option 2: Adopt ITC majority recommendation of 35 percent tariff for five years on imports of western red cedar shingles and shakes.

Advantages

- o Would serve as proof that USG is committed to viability of Section 201 relief as means of affording temporary safeguard protection, particularly following negative determination for footwear.
- o Would give us more time to assess industry's ability to use new methods and alternative materials to achieve international competitiveness.
- o Would give U.S. shake and shingle industry "cushion" while Government considers action on important cause of industry's competitive problem, i.e., access to unpro-

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cessed Canadian logs.

-- Industry would support immediate termination of relief were Canadian log export restrictions removed.

- o Would mean less unemployment initially. Estimated that approximately 40-100 jobs would be preserved in first tariff year. (However, employment in industry would be below current employment levels at end of relief period.)
- o Initially, domestic production may increase between 3 and 7 percent.
- o Initially, domestic prices may increase between 4 and 9 percent, to the benefit of industry.
- o Tariff is unbound under GATT; therefore United States would owe no compensation to trading partners in event of duty increase.

Option 3: Adopt five-year degressive tariff (i.e., 35 percent until month 30, 20 percent in months 30-54 and 8 percent in months 54-60), but have the President direct the USTR to request that ITC conduct review of industry's adjustment efforts after 30 months so that he can determine whether continuation of import relief is in the national economic interest.

Advantages

- o Same as in option 2 (although initial employment, production and price gains would be lost more rapidly as tariff levels declined).
- o Would be consistent with our normal practice of degenerativity and enunciated policy under Section 201.
- o Industry could support degressive tariff of this nature.
- o Might evoke less opposition from Canada than straight-line tariff.
- o Would create less consumer costs in months 30-60 than Option 2.
- o Could spur greater industry effort toward adjustment.

-- Industry has committed in writing to spending \$100,000 per year for research for each year of relief.

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THE UNITED STATES TRADE REPRESENTATIVE
WASHINGTON
20508

May 8, 1986

MEMORANDUM FOR THE ECONOMIC POLICY COUNCIL

FROM: TRADE POLICY REVIEW GROUP

SUBJECT: Brazilian Informatics Section 301

ISSUE

On September 7, 1985, the President directed USTR to self-initiate a section 301 investigation of unfair Brazilian trading practices which restrict U.S. trade and investment in the area of computers and related equipment. To date, the Brazilian Government has shown no willingness to negotiate a solution to the "informatics" case. The EPC must now decide how to proceed with the case.

BACKGROUND

Section 301 Cases

- o The Brazilian informatics case is one of three section 301 investigations self-initiated by the Administration last September. The other two cases are Japanese tobacco and Korean insurance. Under the law, the President has until September 16 to make a determination as to whether these foreign practices violate section 301 and, if so, how the U.S.G. should respond to them. A fourth self-initiated section 301 case, Korean intellectual property rights, comes due in October.
- o To date, we have made progress on the Korean insurance, Korean intellectual property, and Japanese tobacco cases. We expect negotiated solutions to the Korean insurance and Korean intellectual property cases within the statutory time limits. Although Japanese tobacco was delayed by priority negotiations over other bilateral issues, the Japanese have been cooperative thus far.

Brazilian Informatics Policy

- o The informatics investigation challenges a Brazilian regime that severely restricts U.S. trade and investment in the informatics sector and withholds explicit copyright protection

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for computer software. The GOB's policies have resulted in a rapid and unchecked proliferation of restrictions on U.S. informatics products.

- o Since the early 1970's, Brazil has singlemindedly pursued the goal of developing an indigenous computer industry. Under its "market reserve" policy, the GOB prohibits the importation of designated informatics products from the U.S., bars the manufacture of such products in Brazil by subsidiaries of U.S. firms, and imposes local content and export performance requirements on U.S. firms. Under the so-called "Law of Similars," the GOB prohibits the importation of any product containing a computer chip if a Brazilian firm is producing a "national similar."
- o Contrary to internationally accepted norms, Brazil does not provide explicit copyright protection to computer software. As a result, software piracy is endemic in Brazil. In addition, the GOB has accelerated consideration of a draft decree that would prohibit the importation of computer software with a Brazilian "national similar" and prohibit any contractual references to intellectual property rights.
- o A comparative market analysis prepared by the Commerce Department suggests that the GOB's informatics policies cost the U.S. \$1.5 billion in sales of hardware and software from 1980-84. The analysis projects future losses of \$8.1 billion from 1985-92, assuming the policy remains in effect.
- o Informatics is a highly nationalistic issue in Brazil. To date, the GOB has shown no willingness to negotiate and indeed has made a number of inflammatory statements about the U.S. decision to pursue the Section 301 case.
- o While the U.S. industry has to date supported our efforts to limit the scope and duration of the informatics policy, some U.S. companies with operations in Brazil are deeply concerned by the potential impact of any Brazilian counter-retaliation on their investments and future commercial activities. Consequently, the industry is deeply divided on retaliation.

Implications for U.S. Policies

- o The informatics issue is one example of the troubled state of U.S. economic relations with Brazil. Despite its debt problems, Brazil is now the world's 10th largest economy. In 1985, Brazil had a GDP of \$235 billion in 1985, a per capita GDP of \$1990, and the highest growth rate in the free world. Its trade surplus was \$12.5 billion, the third largest in the world after Japan and West Germany, and more than enough to cover its debt payments of \$10.5 billion.

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- o Since the early 20th century, however, the GOB has pursued an autarkic policy of encouraging industrial development through "import substitution." Currently, Brazil's ratio of imports to GDP is 3 percent (excluding oil imports), the lowest in the world.
- o Given Brazil's policy of heavy government intervention in trade flows and strong trade performance, U.S. economic relations with Brazil are extremely contentious. We face a large number of sectoral issues, as well as fundamental disagreements on a new round of trade negotiations. On the financial front, Brazil has refused to adopt an IMF stabilization program and has not made payments on either principal or interest to official creditors for over a year.
- o From the standpoint of U.S. trade policy, the informatics case is the first time that we have challenged restrictions on high tech trade and investment by a newly industrializing country (NIC). An increasing number of NIC's and LDC's have begun to adopt policies designed to foster the development of infant high tech industries through restrictions on imports and investment that appear to be inconsistent with Article XVIII of the GATT.
- o It can be argued that the spread of market reserve policies could turn U.S. trade into a one-way street where the U.S. accepts large quantities of labor-intensive manufactures from LDC's, but is barred from exporting high tech goods. This development could adversely affect U.S. terms of trade and weaken political support for keeping the U.S. market open to imports from debt-burdened LDC's.

Options

By inter-agency agreement, the USG scheduled this interim review of progress on the informatics case. Given the GOB's refusal to negotiate, the EPC must now face some basic choices about our approach to the Brazilian Informatics investigation.

Option 1. Continue current efforts to pursue bilateral negotiations with the Brazilians

This option would not include a report to the President or any action by the EPC at this time.

One possible opening is that Foreign Minister Sodre recently replied to Secretary Shultz's letter on informatics. While the bulk of the Sodre letter consists of a denial that the GOB's informatics policy has had an adverse effect on U.S. economic interests

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and a spirited defense of the policy's legality, the last paragraph invites personal "discussions" between Secretary Shultz and Sodre. We have no assurances, however, that the GOB is willing to enter into serious negotiations, and there are a number of indications to the contrary.

Advantages

- o Over the short-term, avoids additional friction with the GOB.
- o By limiting any further escalation, preserves the possibility of backing away from the case.

Disadvantages

- o Based on past experience with the GOB and recent intelligence reporting, the GOB may be trying to use the consultations proposed Shultz-Sodre discussions as a delaying tactic rather than as a serious effort to address U.S. concerns.
- o Continuation of current, unsatisfactory deadlock on informatics is likely to result in embarrassment of the President. By directing USTR to self-initiate a section 301 investigation, the President publicly defined the USG's position on the Brazilian informatics regime.
- o Inaction is likely to reinforce GOB's current impression that the USG is not serious about the case and that the Administration is not prepared to take countermeasures, thereby reducing incentives to negotiate.
- o Could back us into a corner when statutory deadline for section 301 investigation expires on September 16, 1985. Because the Brazilian practices are so egregious, a decision in September to back away from the case is likely to provide ammunition to Congressional critics of broad Administration discretion under Section 201 and 301.
- o Failure to take action in a self-initiated case would significantly weaken our credibility on trade (and other) issues with Brazil and to a lesser extent other Latin American governments.
- o The lack of U.S.G. support for its leading high technology firms could encourage the GOB to continue or accelerate its restrictive practices against foreign firms and encourage adoption of similar policies in Latin America and elsewhere in the world.
- o Delaying any countermeasures until September could have

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an even more damaging effect on U.S.-Brazil relations because of close proximity to Brazilian elections in November and President Sarney's visit to the U.S. in October.

Option 2. Obtain informal EPC agreement that Brazilian practices are "unfair" under Section 301 and an EPC directive that the TPRG develop by June 25 a list of potential retaliatory measures against Brazil.

Under this option, the EPC would agree that the Brazilian informatics regime is a violation of Section 301 and would direct the TPRG to develop a package of retaliatory options by June 25. The USG would impose a standstill on trade concessions for the GOB in areas, such as specialty steel, where the Brazilians are currently seeking increased access to the U.S. market. No public announcement would be made of the EPC decision to authorize preparation of a package of countermeasures until the GOB has been informed of the decision and given a reasonable period to respond. If the GOB fails to respond, notice of Section 301 Committee hearings would be published in the Federal Register.

If by July 15, we have not received a commitment from the Brazilians to (1) enter into serious negotiations and (2) to reach agreement by an expeditious date certain, the EPC would recommend to the President that he make a formal finding of unfairness and implement the retaliation. Although Option 2 would allow a further period of time before any countermeasures become effective, we must decide now whether we are prepared to follow through if the GOB continues to refuse to negotiate. To weigh potential retaliation and back away would only increase the damage to our credibility with the GOB and the embarrassment to the President.

Advantages

- o Ratchets up the pressure on the GOB without immediately going to the final step of retaliation.
- o Offers convincing evidence that the USG is serious about the informatics investigation and therefore maximizes the incentives for the GOB to enter into meaningful negotiations.
- o Demonstrates Administration resolve in countering unfair trade practices.
- o Assuming that the GOB refuses to negotiate, has the advantages listed in Option 4 with respect to retaliation.

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- o Allows flexibility of response insofar as no formal Presidential determination of unfairness is made at this time.
- o Doesn't foreclose negotiations as long as the GOB is prepared to negotiate an expeditious solution in good faith.

Disadvantages

- o Assuming that the GOB refuses to negotiate and the U.S. imposes counter-measures, has the disadvantages listed in Option 4 with respect to retaliation.
- o While this option is designed to increase the pressure on the GOB, the GOB may be reluctant to give the appearance of entering into negotiations under a U.S. threat. (On the other hand, the prospects for serious negotiations appear rather small under the status quo.)
- o By increasing the pressure on informatics, could discourage bilateral progress with Brazil on other issues.
- o May not be enough to bring the GOB to the table.
- o Removes the EPC from its traditional role of advising the President and instead uses the Council in developing negotiating leverage.

Option 3. Obtain a Presidential finding of unfairness now under Section 301 with a Presidential directive to the EPC to develop a list of potential retaliatory measures.

This option would proceed in essentially the same way as Option 2, but would involve the President at an earlier stage through an EPC recommendation asking the President to make a formal finding of unfairness now. Implementation of the retaliatory package, however, would be delayed as outlined in Option 2.

This Option has essentially the same advantages and disadvantages as Option 2, but with these additions.

Advantages

- o Elevates visibility of decision, and potentially increases pressure on the Brazilians by having a Presidential determination early in the case.
- o More closely corresponds with traditional EPC role of advising the President, rather than acting on its own authority.

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Disadvantages

- o By involving the President too early in the case, could hamper our flexibility to negotiate a settlement.

Option 4. Recommend a Presidential determination of unfairness now, with immediate implementation of retaliation.

This Option involves a Presidential determination of unfairness accompanied by a Presidential directive to immediately implement retaliatory measures. The President would be informed of the magnitude of the proposed retaliation and the likely targets for retaliation.

Advantages

- o Demonstrates Administration's forcefulness in countering unfair trade practices.
- o By illustrating possible course of retaliation and counter-retaliation, enables the President to better understand the consequences of retaliation at the time that he commits to it by issuing an unfairness determination.
- o By demonstrating Administration resolve, helps to counter legislation to remove the President's discretion under Sections 201 and 301.
- o Demonstrates to the GOB that we have reached the limits of our tolerance on bilateral trade and economic issues and lays down a marker for future negotiations.
- o Could over the long-term encourage an eventual solution to informatics. It has been argued that the GOB only responds to pressure and that, after the initial outcry, the GOB will look for a means to resolve the issue.
- o Could serve as a deterrent to other LDC's contemplating restrictions on U.S. high-tech exports and investment. A number of NIC's and LDC's in South America and elsewhere have begun to copy Brazil's market reserve policy in computers and other sectors.

Disadvantages

- o By antagonizing the GOB, encourages further deterioration in U.S.-Brazil economic relations. Informatics is a highly emotional, nationalistic issue in Brazil and any U.S. action is likely to result in a strong reaction by the GOB and

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Brazilian public opinion.

- o Likely to provoke Brazilian counter-retaliation against U.S. exports to Brazil. Could affect a number of major U.S. exports.
- o Likely to emerge as an issue in November elections in Brazil.
- o The GOB may link any retaliatory measure to its ability to repay its debt, although it is unlikely to default.
- o There is no guarantee that countermeasures will induce the GOB to enter into negotiations.
- o The countermeasures would involve restrictions on Brazilian trade with the U.S. and violate the GATT. The GOB might decide to pursue a GATT dispute settlement case to embarrass us.
- o Retaliation could threaten the interests of U.S. computer firms operating in Brazil and those attempting to do so.

Recommendation

The Trade Policy Review Group unanimously recommends Option 2.

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